

On Date 4, the trustee of Trust 2 filed an election under § 1362(c)(2)(A)(v) to be treated as an ESBT effective Date 5. The ESBT election incorrectly stated that the shares of A owned by Trust 1 prior to the merger were transferred to Trust 2 on Date 5, when the shares were actually transferred on Date 3. A represents that Trust 2 intended the ESBT election to be effective as of Date 3. As a result, A's S corporation election terminated on Date 3 because Trust 2 was an ineligible shareholder.

A represents that the circumstances resulting in the termination of A's S corporation election were inadvertent and not motivated by tax avoidance. A further represents that A filed returns consistent with A's status as an S corporation. A and its shareholders agree to make such adjustments consistent with the treatment of A as an S corporation as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part 1 of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(c)(2)(A)(v) provides that for the purposes of § 1362(b)(1)(B), an electing small business trust may be a shareholder.

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made

and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides, in part, that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) provides, in part, that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Conclusion

Based solely on the facts submitted and representations made, we conclude that the S corporation election for A terminated on Date 3 when the shares of Trust 1 were transferred to Trust 2. We further conclude that the termination was inadvertent within the meaning of § 1362(f) and A will continue to be treated as an S corporation for the period from Date 1 provided that the S corporation election for A was valid and was not otherwise terminated under § 1362(d).

This ruling is conditioned upon the trustee of Trust 2 filing an ESBT election effective Date 3. The election must be filed with the appropriate service center within 120 days of the date of this ruling. A copy of this letter should be attached to the ESBT election.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether A is otherwise eligible to be treated as an S corporation or whether Trust 2 is eligible to be treated as an ESBT. Further, we express or imply no opinion concerning the validity or tax consequences of the merger of Trust 1 and Trust 2.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to A's authorized representatives.

Sincerely,

Adrienne M. Mikolashek
Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of Letter
Copy for 6110 purposes

cc: